FASDA HEIGHTS SDN BHD

v.

SOON EE SING CONSTRUCTION SDN BHD & ANOR

HIGH COURT MALAYA, KUALA LUMPUR
STEVE SHIM J
[ORIGINATING SUMMONS NO: D5-24-394-1998]
25 MARCH 1999

BANKING: *Securities for advances - Guarantee given by bank - Whether bank guarantee similar to performance bond - Whether unconditional or conditional guarantee - Guarantee conditional upon receipt of demand in writing - Whether conditional or mere procedure - Breach of contract - Whether parties to guarantee are required to furnish proof or to inquire into the facts of the condition*

The plaintiff, a developer, entered into a building contract with the 1st defendant, a contractor, for the construction of a mixed development project in Pulau Pinang. Pursuant to the said building contract, the 2nd defendant, a bank, issued a bank guarantee in favour of the plaintiff. Subsequently, the architect for the project issued notices to the 1st defendant requiring the 1st defendant to rectify various defaults. As a result of the 1st defendant's failure to rectify the defaults, the plaintiff issued a notice to the 1st defendant terminating the building contract, and demanded from the 2nd defendant payment under the bank guarantee. Failing to receive any response from the 2nd defendant, the plaintiff applied to the court seeking, *inter alia,* a declaration that the 2nd defendant was liable for payment and interest accrued pursuant to its bank guarantee. The 2nd defendant contended that the bank guarantee was a conditional guarantee and that the plaintiff had not complied strictly with the conditions therein at the time the demand was made. The issue before the court was whether the bank guarantee was an "unconditional bond" or a "conditional bond".

Held:

[1] Whether a performance bond is conditional or unconditional must depend on the terms of the bond itself as established in the case of *Teknik Cekap Sdn Bhd v. Public Bank Berhad*. Here, it was not disputed that the bank guarantee was a performance bond issued by the 2nd defendant to secure the 1st defendant's due performance under the building contract. Hence, the words used in the bank guarantee must be examined.

[2] The words used in the bank guarantee were sufficiently clear. On a proper reading of the bank guarantee, it must be reasonably construed to mean that the 2nd defendant would be liable to release the moneys to the plaintiff immediately only upon the following conditions, namely (1) that the demand was in writing, and (2) the contractor failed to execute the works and/or breached of the building contract.

[3] As regards the "condition" for the demand to be made in writing, it has been said that such a "condition" is merely to regulate the right to call on the guarantee and is therefore purely a procedural matter. It did not render the guarantee conditional in the true sense.

[4] In considering the second "condition", it was clear that the words "in the event that the contractor fails to execute the works and/or in breach of the contract" in the bank guarantee amounted to a condition precedent, which had to be complied with before the 2nd defendant could release the moneys when a demand was made on the bank guarantee by the plaintiff. There was no burden of proof placed on the plaintiff nor was there any obligation on the part of the 2nd defendant to inquire into the facts of the condition or to require proof. Thus, it was wrong for the 2nd defendant to withhold or refuse to pay the moneys to the plaintiff when the demand was made on the bank guarantee at the material time.

[Application allowed with costs; order accordingly.]

Case(s) referred to:

Bocotra Construction Pte Ltd & Ors v. A-G (No 2) [1995] 2 SLR 733 ***(foll)***

Esal (Commodities) Ltd & Anor v. Oriental Credit Ltd & Anor [1985] Lloyd's Law Report 546 ***(refd)***

IE Contractors v. Lloyds Bank [1990] 2 Lloyd's Rep 496 ***(refd)***

Teknik Cekap Sdn Bhd v. Public Bank Bhd [1995] 4 CLJ 697 ***(refd)***

The Radio & General Trading Co Sdn Bhd v. Wayss & Freytag (M) Sdn Bhd [1998] 1 MLJ 346 ***(refd)***

For the plaintiff - SK Yeoh (Libby Ong with him); M/s SK Yeoh & Jeganathan

For the 1st defendant - YW Leong (CH Soo with him); M/s Cheah, Yap & Partners

For the 2nd defendant - KL Low (CN Chen with him); M/s Soo Thien Meng & Nashrah

Reported by Farah Naim

JUDGMENT

Steve Shim J:

By originating summons dated 20 August 1998, the plaintiff seeks the following reliefs:

(1) A declaration that the 2nd defendant is liable pursuant to its Bank Guarantee dated 12 March 1997 to the plaintiff in the sum of RM2,658,425.

(2) A declaration that the 2nd defendant is liable to pay interest on the RM2,658,425 from 14 August 1998 till date of judgment or order.

(3) For an order that the 2nd defendant do make payment of RM2,655,425 to the plaintiff, failing which interest shall accrue on the said sum till date of payment.

At the outset, the factual background leading to this application may be briefly stated. The plaintiff, a developer and the 1st defendant, a contractor entered into a building contract for the purpose of constructing a mixed development and a ten storey building comprising of low cost flats, in Seberang Perai Tengah, Pulau Pinang. Pursuant to the building contract, the 2nd defendant, a bank, issued a bank guarantee dated 12 March 1997 in favour of the plaintiff. In accordance with the same building contract, the architect issued to the 1st defendant notices dated 15 December 1997 and 2 July 1998 requiring the 1st defendant to rectify various defaults. This was not done. As a result, the plaintiff issued a notice dated 27 July 1998 terminating the building contract with the 1st defendant. Thereafter on 31 July 1998, the plaintiff issued a demand against the 2nd defendant on the bank guarantee. As no response was received from the 2nd defendant, the plaintiff issued another demand on the said bank guarantee. Again the 2nd defendant did not respond. Hence, this application before me.

It is important to note that the application is directed specifically at the 2nd defendant, RHB Bank Bhd. The orders sought by the plaintiff are in effect in the nature of a mandatory injunction compelling the 2nd defendant to release the monies to the plaintiff under the bank guarantee dated 12 March 1997. I draw attention to this fact because from a perusal of the written submissions tendered by counsels for the parties concerned, they seem, at times, to have lost sight of the real purpose and intent of the application by embarking, with apparent nonchalance and unbridled exuberance and energy, on a discourse related more to the issue of whether or not the plaintiff ought to be restrained from making the demand on the bank guarantee. Certainly that is a matter for which a different or separate application is open to the 1st defendant. We

are not directly concerned with that for the moment. Here, the application is concentrated and focussed on the 2nd defendant alone.

Now, the principal if not the sole ground relied upon by the plaintiff (as can be ascertained from the supporting affidavit) seems to hinge on the unconditionality of the bank guarantee. This is reinforced by an alternative stand that if the bank guarantee was a conditional one, the condition or conditions had been complied with. The defendants, in opposing the application, have contended that the bank guarantee was a conditional guarantee and the plaintiff had not complied strictly with the conditions therein at the time the demand was made on the bank guarantee.

Given the conflicting positions taken by the parties in this case, it is, I think pertinent to acquaint, ourselves with the applicable principles laid down in some of the decided cases. In *Teknik Cekap Sdn Bhd v. Public Bank Bhd* [1995] 4 CLJ 697; [1995] 3 MLJ 449, Shaik Daud, JCA had occasion to talk about the nature and scope of a performance bond. He said *inter alia*:

> ... What therefore is a performance bond. As I see it there is nothing special or unique in a performance bond. It is in fact a written contract of guarantee by a bank, other financial institutions or in some cases an insurance company, whereby they guarantee the due performance of a contract and in the event of a breach or non-performance of the contract, they guarantee to pay, on a written demand being made the sum stipulated in the guarantee. Therefore a performance bond is nothing more than a written guarantee, and in order to interpret the obligations of the bank, one need only to look at the written bond itself to determine what are the terms and conditions agreed upon between the parties. A great deal, therefore, depends on the wording of the bond itself.

His Lordship then went on to state, after having reviewed the relevant English authorities, that the courts had adopted a strict interpretation of performance bonds and that in making demands on them the beneficiary must adhere strictly to their terms. In approving this strict interpretation approach the learned judge said this:

> This line of interpretation seems to me to be more sensible as it requires the beneficiary of the performance bond to state in plain terms that which they must, if honest, be prepared to assert, and may place him in peril of a charge of obtaining money by deception if later it turns out to be untrue to his knowledge. Furthermore banks, other financial institutions and perhaps insurance companies, would be left to assume that a breach of the contract had taken place. This is more so as they cannot challenge the demand. The banks are in fact not required to be told the nature of the breach or who is to be blamed for the breach. That is not the concern of the bank but it must be asserted that the demand is made as a result of a breach by the sub-contractor.

It seems clear from *Teknik Cekap supra*, that in order to determine whether a performance bond is conditional or unconditional it must depend upon the terms of the bond itself. This approach is also adopted in the Singapore case of *Bocotra Construction Pte Ltd & Ors v. Attorney General (No. 2)* [1995] 2 SLR 733 (CA) as reflected in particular that passage of the judgment of Karthigesu JA which reads:

> Ultimately, this raises a question of construction, and of examining the intent of document. This approach is clearly borne out in numerous cases, including the two cited above. A recent authority for this proposition emanating from a source closer to home is that of the Malaysian Supreme Court in *Esso Petroleum Malaysia Inc v. Kago Petroleum Sdn Bhd.* Peh Swee Chin, SCJ, delivering the court's judgment, opined that the real issue was one of contractual interpretation of the performance bond and not the nature of the transaction. We consider this to be the correct approach to adopt.

The two cases referred by His Lordship are *Esal (Commodities) Ltd & Anor v. Oriental Credit Ltd & Anor* [1985] Lloyd's Law Report 546 and *IE Contractors v. Lloyds Bank* [1990] 2 Lloyd's Rep 496.

In the instant case, it has not been disputed that the bank guarantee is, in substance, a performance bond issued by the 2nd defendant (a bank) to secure the 1st defendant's due performance under the building contract. It is in the light of the established principles aforesaid that the bank guarantee in this case has to be construed. It is incumbent upon this court to look at the words used in the said bank guarantee which read as follows:

> ... which shall become payable by us immediately on receipt of notice in writing given to us by the Employer M/s Fasda Heights Sdn Bhd or its authorised representative in the event of the contractor M/s Soon Ee Sing Construction Sendirian Berhad failing to execute the works and/or in breach of contract.

Here, counsel for the plaintiff has laid emphasis on the imperative use of the words "immediately on receipt of the notice in writing" and submits that those words must be construed to require the 2nd defendant to make immediate payment upon demand and precludes an interpretation that the 2nd defendant is entitled or required to make any inquiry relating to any alleged failure on the part of the contractor to execute the works and/or in breach of contract, before horouring the plaintiff's demand. Counsel for the 1st defendant has however drawn attention to the significance of the words "in the event of the contractor failing to execute the works and/or in breach of contract" therein and submits that when read in the light of the whole paragraph, no liability exists under the said bank guarantee unless and until there has been a breach of the underlying building contract which, according to him, has to be established before a demand can be made or entertained. He has laboured on

this at some length by referring to certain English authorities but it seems that the thrust of his contention relates more to the question of whether or not it is right and/or equitable and/or unconscionable for the plaintiff to call upon the bank guarantee. I do not think this issue is of direct relevance to the application. This will become apparent later. In the meanwhile, let me revert to the issue at hand and consider the position taken by counsel for the 2nd defendant. In substance, I think he is adopting a similar stand as counsel for the 1st defendant although he has added a supplementary by submitting that the absence of such words as "unequivocal" or "unconditional" or "absolutely" in the bank guarantee has the effect of militating against its unconditionality.

In my view, the words used in the bank guarantee are sufficiently clear. On a proper reading of the whole paragraph cited above, they must reasonably be construed to mean that the bank (2nd defendant) would be liable to release the monies to the plaintiff immediately only upon the following "conditions" namely (1) that the demand is in writing and (2) the contractor fails to execute the works and/or in breach of the contract. In this context it is significant to consider the nature and effect of the "conditions" above.

As regards the "condition" for the demand to be made in writing, it has been said that such a "condition" is merely to regulate the right to call on the guarantee and in therefore purely a procedural matter. It does not render a guarantee conditional in the true sense (see *Bocotra Construction Pte Ltd v. A-G (No 2)* [1995] 2 SLR 733 (CA). I am prepared to adopt that as a correct statement of law. That being the position, the requirement to make the demand in writing in this case does not render the bank guarantee conditional in the real sense.

In considering the 2nd "condition" *ie*, in the event the contractor fails to execute the works and/or in breach of the contract, I think it pertinent to cite the English case of *Esal (Commodities) Ltd and Reltor Ltd v. Oriental Credit Ltd & Wells Fargo Bank NA* [1985] 2 CA 546 to see how the Court of Appeal in that case dealt with a performance bond which, in effect and in substance, is similar to the bank guarantee in our case. In that case, the bond provided as follows:

> We undertake to pay the said amount on your written demand **in the event that the supplier fails to execute the contract in perfect performance ...**

It was held that there were three possible meanings for the words used: (i) that no more than a written demand was required, (ii) that the demand must assert a failure to perform the contract, or (iii) that there must in fact have been a failure to perform. The Court of Appeal unanimously rejected the third solution. This was reflected in that part of the speech by Ackner LJ, which stated:

> If the performance bound was so conditional, then unless there was clear evidence that the seller admitted that he was in breach of the contract of sale, payment could safely be made by the bank except on a judgment of a court of competent jurisdiction and this result would be wholly inconsistent with the entire object of the transaction, namely, to enable the beneficiary to obtain prompt and certain payment.

This apparently prompted Staughton LJ in *IE Contractors v. Lloyds Bank & Rafidain Bank, supra* to conclude that there was a bias or presumption in favour of the construction that performance bond was to be conditioned upon documents rather than facts. In any event, the Court of Appeal in *Esal* by a majority, opted for the second construction that the demand must assert the failure to perform the contract. This was how Ackner LJ put it:

> However, I accept Mr. Tugendhat's alternative submission that in addition to the beneficiary making the demand. We must also inform the bank that he does so on the basis provided for in the performance bond itself. This interpretation not only gives meaning and effect to the words 'in the event that the supplier fails ...' which otherwise would be mere surplusage, but it in no way imposes an extravagant demand upon the bank. A bank beneficiary may seek, honestly or dishonestly, to apply a performance bond to the wrong contract, and the need to inform the bank of the true basis upon which he is making his demand may be vary salutary.

This view of the contruction was accepted by Staughton LJ in *IE Contractors* as correct because, according to him, it would require the beneficiary to state in plain terms that which he must, if honest, be prepared to assert and might place him in peril of a charge of obtaining money by deception if it were untrue to his knowledge. It is to be noted this same reasoning was accepted by Shaik Daud JCA in *Teknik Cekap, supra*. There the Court of Appeal was asked to construe a performance bond which read:

> If the sub-contractor (unless relieved from the performance of any clause of the contract or by statute or by the decision of a tribunal of competent jurisdiction) shall in any respect fail to execute the contract or commit any breach of his obligations thereunder then the guarantor shall pay to the contractor up to and not exceeding the sum of RM422,000 (Malaysian Ringgit: Four hundred twenty two thousand) only representing 10% of the contract value or such part thereof on the contractor's demand notwithstanding any contestation on protest by the sub-contractor as by any other third party, provided always that the total of all partial demands so made shall not exceed the sum of RM422,000 (Malaysian Ringgit four hundred twenty two thousand) only at that the guarantor's liability to pay the contractor as aforesaid shall correspondingly be reduced proportionate to by partial demand having been made as aforesaid.

The Court of Appeal in construing the above performance bond, accepted the approach in *Esal*, and held that from the words used, it was clear and unequivocal that what would trigger off the guarantee was the sub-contractors failure to execute the contract or commit any breach thereof. The Court of Appeal noted that in *Esal,* it was held that in making the demands, the beneficiary did not assert there was a failure to perform the contract and hence came to the conclusion that liability under the performance bond was conditional and the condition had not been complied with. Applying that approach, to the performance bond before them, the Court of Appeal then held that the appellant had failed to assert the very basis of the demand as required by the bond and therefore the letter of demand made pursuant to the performance bond was invalid and consequently any payment made thereunder by the bank was also invalid. Shaik Daud JCA reiterated that the learned judge in the court below was right in holding that in the circumstances of that case, the demand made pursuant to the bond must assert the failure of the sub-contractor to execute the sub-contract before the said demand could be met and paid.

In my view, the same approach can be taken in the present case. It is therefore clear that the words "in the event the contractor fails to execute the works and/or in breach of the contract" in the bank guarantee amount to a condition precedent. It means that this condition has to be complied with before the 2nd defendant can release the monies when a demand is made on the bank guarantee by the plaintiff. I may add that at this stage, there is no burden of proof placed on the beneficiary nor is there any obligation on the part of the bank to inquire into the facts of the condition or require proof thereof. In the light of the authorities cited where it was held sufficient in such a situation for the beneficiary to assert clearly in the demand the condition or conditions stipulated in the performance bond, there is therefore a necessity to take a closer look at the demand made by the plaintiff on the bank guarantee in the instant case. The plaintiff had in fact sent two letters of demand on the bank guarantee. The first demand dated 31 July 1998 – the relevant part of which states:

> 1. We refer to your Bank Guarantee (BG) dated the 12th March 1997 (Your Ref. 70015-700175).
>
> 2. ...
>
> 3. **Non-execution of Works ad breach of Building Contract.**
>
> Further please take note that Soon Ee Sing Construction Sdn Bhd (the Contractor) has failed to execute the Project Works in accordance with the Building Contract and/or is in breach of the Building Contract ...

4. **Claim on BG**

> By reason of paragraph 3 above and pursuant to the BG, we hereby demand that the sum of RM2,655,425.00 is forthwith paid to us ...

The second demand dated 11 August 1998 was couched in substantially similar terms. From the contents therein, it is clear that the plaintiff had asserted positively that the contractor had failed to execute the works under the building contract. There was also annexed to the letters of demand two certificates issued by the architect. In my view, the assertions as reflected in the two letters of demand, were sufficient "to trigger off the guarantee" (in the words of Shaik Daud, JCA in *Teknik Cekap*) and on that basis, it is clear that the condition stipulated in the bank guarantee had been complied with and therefore the 2nd defendant (bank) had no option but to release the monies to the plaintiff. In the circumstances, it was wrong for the 2nd defendant to withhold or refuse to pay the monies to the plaintiff when the demand was made on the bank guarantee at the material time.

I now come to the other issues raised by the defendants, namely (1) that the bank guarantee had lapsed at the time the demand was made and (2) that it was unconscionable and inequitable for the plaintiff to receive the proceeds under the bank guarantee. On the first issue, counsel for the 1st defendant has contended that the bank guarantee was effective only from 12 March 1997 to 11 March 1998 and further that any call on it must be made within the effective period; that since the demand by the plaintiff was made on 31 July 1998, outside the validity period, it was therefore bad. Counsel for the 2nd defendant submits that, at all material times, the plaintiff knew that the bank guarantee had lapsed. In response, counsel for the plaintiff contends that the validity clause in the bank guarantee is ambiguous and therefore the principle of *contra proferentum* applies.

Now, para 2 of the bank guarantee stipulates as follows:

> This guarantee shall be irrevocable and is effective from the 12th March 1997 to the 11th March 1998 and is to remain in force until one month after the issue of the Certificate on Practical Completion of the works by the Architect or until a notice in writing to discontinue the said Security Deposit Fund is given by the Employer M/s Fasda Heights Sdn Bhd ...

In my view, in order to make sense of the clause, it must be read as a whole. If read as a whole, it could not be interpreted to mean that the guarantee would expire on 11 March 1998 because of the presence of the following words "and is to remain in force until ..." For the whole clause to have any efficacy and to make any proper sense to the words therein they must be construed to mean that the guarantee is to be valid from 12 March 1997 until one month after

the issue of the Certificate of Practical Completion of the Works by the Architect or until a notice in writing to discontinue the Security Deposit Fund is given by the employer M/s Fasda Heights Sdn Bhd. In my view, the date of "11 March 1998" is mere surplusage. In the instant case, there is no indication that, at the time when the demand was made by the plaintiff on the bank guarantee on 31 July 1998, there was any issue of the relevant certificate by the architect or any notice to discontinue given by the employer. In the circumstances, the demand was made within the validity period. For the reasons stated, I find no merit in the defendant's contention on this score.

As regards the alternative contention that if there was no lapse, the bank guarantee would nevertheless be ineffective in view of the plaintiff's act of terminating the building contract. I have to say that I am unable to comprehend the rationality of such a contention. It has no merit whatsoever.

The other collateral issue raised by the 1st defendant is that it would be unconscionable and inequitable for the plaintiff to receive the proceeds under the bank guarantee. This is in effect a plea to restrain the plaintiff from calling on the bank guarantee, which, as I have said before, is a subject-matter of a different application falling within the discretion of the 1st defendant. I do not think it is directly relevant to the present application. Indeed the case of *The Radio & General Trading Co Sdn Bhd v. Wayss & Freytag (M) Sdn Bhd* [1998] 1 MLJ 346 relied on by counsel for the 1st defendant related to an application by the plaintiff to restrain the defendant from calling on the performance bond. Here, we are concerned with an application for declaratory reliefs against the 2nd defendant (bank) on the basis of the interpretation and effect of the bank guarantee. In the circumstances, the issue of unconscionability or inequity does not really arise in this application.

In summary therefore, having regard to the law, facts and circumstances and for the reasons stated, I find there are sufficient merits in the application. Accordingly, I will allow it with cost. Order in terms of the application.